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IN THE

Supreme Court of the United States

October
APRIL TERM, 1936 (1935)

24

ALGERNON S. SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

25

EDWARD SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

26

LEONARD SCHAFER, *Petitioner*,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

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ALGERNON S. SCHAFER, Petitioner, v. GUY T. HELVERING, Commissioner of Internal Revenue, Respondent.	No.....
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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA, AND BRIEF IN SUPPORT THEREOF.

The petitioners, Algernon S. Schafer, Edward Schafer and Leonard Schafer, by their attorneys, Eugene Untermyer and

Edgar J. Goodrich, pray that Writs of Certiorari issue to review the decisions of the United States Court of Appeals for the District of Columbia, rendered in the above-entitled cases on March 2, 1936, affirming the Orders of the United States Board of Tax Appeals entered March 30, 1935 (32 B. T. A. 289) (R. 33-42), approving the determinations of the Commissioner of Internal Revenue finding deficiencies in income tax for the calendar year 1929 as to each petitioner.

Question Presented.

Was the partnership of which these petitioners were members a "dealer in securities" as to securities bought and sold for its own account, and as such entitled to inventory such securities at cost or market, whichever was lower, in computing its income for 1929?

The same question is involved in each of these cases since the income of each petitioner for 1929 includes his distributable share of the income of the partnership for that year. Determination of the amount thus to be included in the income of each petitioner depends upon the basis upon which the partnership income is computed.

This identical issue, which involves the liabilities of many taxpayers, has been decided by the Courts of Appeal for the Second and Third Circuits in cases indistinguishable upon their facts from the instant proceedings, in direct contradiction to the decision herein of the Court of Appeals of the District of Columbia.

Statutes and Regulations Involved.

Revenue Act of 1928 (U. S. C. A., Title 26, Chap. 1, p. 51):

> "SECTION 22(c): *Inventories:* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such tax-

payer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income."

Regulations 74:

"ARTICLE 106. *Inventories by Dealers in Securities.* A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merc' buys securities and sells them to customers wit a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule."

Statement.

These cases were consolidated for trial below. At all times here material the petitioners were general partners, each having a one-third interest, in the firm of Schafer Brothers,

which was an established firm, engaged for upwards of fifty years as members of the New York Stock Exchange in the business of a broker and dealer in securities. Its activities included (1) the execution of orders for purchase or sale upon the various Exchanges of securities for its customers, (2) the participation in syndicate and underwriting operations, and (3) the purchase and sale of securities for profit on its own account, which was an essential part of the firm's business and had been so for many years.

From 1925 to 1929, inclusive, in accordance with a ruling published by the Treasury Department in 1922 that stood unquestioned for some nine years, and as it was required by the rules of the New York Stock Exchange, the firm inventoried the securities purchased and held by it for resale at a profit, at market values at the beginning and end of the year, and determined its income from this source upon the inventory basis.

This method of computing the firm's income was accepted by the Commissioner for all years up to 1929. For that year, in auditing the firm's returns in 1931, he denied the partnership the right to use the inventory basis in computing its income on the ground that the firm was not a "dealer in securities" with respect to the securities which it purchased and sold for its own account that had remained unsold at the beginning and end of the taxable year.

This action resulted in increasing the firm's income for 1929 (in prior years such action would have decreased the firm's income) and consequently increased substantially the taxable income of each of the partners. Based on such increases to the firm's and to the individual's incomes, the Commissioner determined tax deficiencies for 1929 against these petitioners in the respective amounts of $33,329.20, $33,423.09 and $32,687.97.

Against these determinations of the Commissioner, petitioners appealed to the Board of Tax Appeals, which affirmed. From the decisions of the Board of Tax Appeals, petitioners appealed to the Court of Appeals of the District of Columbia. That Court affirmed the Board's order, ex-

pressly refusing to follow prior decisions of identical issues by the Courts of Appeal for the Second and Third Circuits in cases indistinguishable upon their facts from the instant proceedings.

The issuance of mandates has been stayed pending action upon application in this Court for Writs of Certiorari.

Specification of Errors to Be Urged.

The Court of Appeals of the District of Columbia erred:

1. In failing to hold that the firm of Schafer Brothers was a dealer in securities in 1929 as to those securities which it bought and sold for profit on its own account, and as such entitled to determine its income for 1929 upon the inventory basis.

2. In failing to hold that the use of inventories in 1929 by the firm of Schafer Brothers with respect to the securities it bought and sold for profit on its own account was essential in order clearly to determine the income of the firm, and consequently the income of each of these petitioners, in accordance with the best accounting practice, with the requirements of the Bureau of Internal Revenue and with the rules of the Stock Exchange.

3. In holding, directly in contradiction to decisions by the Courts of Appeal for the Second and Third Circuits upon issues identical with those here involved arising under factual situations indistinguishable from those obtaining in these proceedings, that the firm of Schafer Brothers was not a dealer in securities in 1929 as to the securities in which it traded for profit on its own account, and as such entitled to the use of inventories respecting such securities in determining its income and the respective distributable shares thereof of each of these petitioners.

Reasons for Granting the Writs.

1. The decision of the Court of Appeals of the District of Columbia is in irreconcilable conflict on a matter of statutory interpretation with the decision of the Court of Appeals for the Second Circuit in *Commissioner* v. *Stevens*, 78 Fed. (2d) 713, and with the decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Chararay*, 79 Fed. (2d) 406.

2. The precise question of statutory construction here presented is one of general public importance which has never been settled, and should be determined by this Court because of the number of pending cases involving the question, as well as the frequent occasions that the question is bound to arise in the future.

WHEREFORE, it is respectfully submitted that this petition should be granted.

Dated April 6, 1936.

ALGERNON S. SCHAFER,
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LEONARD SCHAFER,
Petitioners,

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BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Statement.

The facts, the question presented, the opinions below, the statute and regulations involved, and the specification of errors are all set out in the Petition.

The *jurisdiction of this Court* is invoked under Section 240(a) of the Judicial Code, as amended by Act of February 13, 1925 (c-229, #1, 43 Stat. 938).

This brief is directed, not to the merits of the decisions below imposing upon petitioners the tax liabilities complained of, but solely to the reasons impelling review of these cases and decisions of the issues involved by this Court.

Argument.

(1) The decision of the Court of Appeals of the District of Columbia is in irreconcilable conflict on a matter of statutory interpretation with the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Stevens*, 78 Fed. (2d) 713, and with the decision of the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Charavay*, 79 Fed. (2d) 406.

The Court of Appeals of the District of Columbia by its express disagreement with the opinions of the Courts of Appeals for the Second and Third Circuits has created a direct conflict respecting the judicial definition and construction of the term "dealer in securities."

That this disagreement is a true conflict involving judicial interpretation of a statutory term and is not merely the result of distinguishing factual situations is expressly stated in the opinion of the Court of Appeals as follows:

> "Petitioners rely upon *Commissioner* v. *Stevens* (Second Circuit), 78 Fed. (2d) 713, and *Commissioner* v. *Charavay* (Third Circuit), 79 Fed. (2d) 406, and insist that the facts in those cases and in this are indistinguishable; and in our opinion this is correct. If we follow them, we should be content to accept their conclusions as our own; but after careful thought, and with great deference, we are constrained to adopt a different view."

A clear and undisputed construction and understanding of the term "dealer in securities" is essential to the proper application of the statutory provisions respecting the use of inventories by all persons engaged in the securities business in determining their annual income subject to tax.

If a taxpayer is a "dealer in securities," he is permitted to inventory at the beginning and end of each year the securities on hand which he has purchased for resale at a profit. If a taxpayer is not a "dealer in securities," his income derived from purchase and resale of securities is to be determined, not upon the inventory basis, but upon the basis of actual sales. Unless one method or the other is consistently followed there may be a substantial difference in any one year in computation of income from that source.

That result is demonstrated in the cases at bar. Here, Schafer Brothers for a number of years had computed its income from purchase and sales of securities for its own account on the inventory basis. The sudden rejection of that basis in 1931 by the Commissioner for the taxable year 1929 and the use by him of the actual sales basis in computing the firm's income for that year resulted in an increase on paper in the firm's income of $511,667 over the amount disclosed by its tax return. That change of course was reflected in increased computations of the incomes of the partners, these petitioners, resulting in the tax deficiencies here involved.

As the matter now stands, under the construction and interpretation of the term "dealer in securities" by the Courts of the Second and Third Circuits, the firm of Schafer Brothers was such a dealer, entitled to inventory its securities on hand and compute its income on the inventory basis.

We urge that the firm is in all respects a dealer in securities within the language of the Regulation (p. 3 of the Petition, *supra*) with respect to its purchases and sales of securities for its own account.

It had consistently inventoried its securities by the same method and adhered thereto in subsequent years.

The firm had an established place of business, regularly engaged in the purchase of securities and their resale to customers (the word customers includes "other brokers" as was determined in *Commissioner* v. *Stevens, supra,* p. 714) with a view to the gains and profits to be derived therefrom.

Such securities were all held for purpose of resale and not for investment, as was stipulated and found by the Board.

The transactions in question were in the course of an established business and not in the individual capacities of any of the partners.

The conclusion that Schafer Brothers was a "dealer" is inescapable, for by their decisions in the *Stevens* and *Chararay* cases (*supra*) those Courts held the firm of Stevens and Legg, engaged in a business precisely the same as that of Schafer Brothers, buying and selling securities for profit on its own account exactly as did Schafer Brothers, to be a "dealer in securities" with respect to such securities, and entitled to compute its income from that source on the inventory basis.

Under the construction of the term "dealer in securities" given by the Courts of the Second and Third Circuits, it follows that Schafer Brothers was such a dealer, and its tax return for 1929 correctly disclosed its income from purchase and sale of securities; so also did the individual tax returns of these petitioners, and they are not chargeable with the deficiencies asserted.

But under the construction and interpretation of that term by the Court of Appeals of the District of Columbia, its decision holds that the firm of Schafer Brothers was not a "dealer in securities," its income from purchase and resale of securities should be determined upon the actual sales basis and consequently its income as disclosed by its return was understated, as were also the incomes of these petitioners.

Consequently, the refusal of the Court of Appeals of the District of Columbia to accept and follow the prior decisions of the Court of the Second and Third Circuits, despite its admission that the factual situations in all three cases are

indistinguishable, evidences a fundamental conflict in construction and interpretation of a statutory term essential to a proper application of the statutory provisions. Because of this conflict opposite and irreconcilable results obtain in the different Circuits in cases arising upon the same set of facts.

Such a conflict, we submit, clearly indicates the necessity for examination and decision of these cases by this Court under Rule 38(5)(b), and we respectfully urge the writs be granted.

(2) The precise question of statutory construction here presented is one of general public importance which has never been settled, and should be determined by this Court because of the number of pending cases involving the question, as well as the frequent occasions on which the question is bound to arise in the future.

The necessity for decision of the issues here involved and the judicial construction of the essential term "dealer in securities" by this Court of highest authority is not confined to the demands of justice in the instant proceedings.

Upon the correct construction and interpretation of the statutory terms involved depends the proper determination of the tax liabilities of the substantial number of established business concerns engaged in the purchase and resale of securities. The proper status of the firm, whether as "dealers" or otherwise, the proper method upon which its accounts shall be kept and its income computed, and the resulting liabilities of the partners under the revenue laws all depend upon final and authoritative judicial determination of the issues involved in the cases now at bar.

Upon information, unofficial and unpublished, but which we believe to be dependable, we state that there are a very substantial number of cases involving these issues now pending in the Bureau of Internal Revenue.

There are also numerous cases which would be controlled by decision of this Court in the instant proceedings pending before the Board of Tax Appeals and the federal District

Courts, and upon appeal from those tribunals before the several Circuit Courts of Appeal. Because of the fundamental conflict now existing between the Courts of the Second and Third Circuits on the one hand and the Court of Appeals of the District of Columbia on the other clearly a definitive determination of these pending cases is impossible.

The sudden reversal of opinion by the Commissioner, in diametrical opposition to his practice of over nine years, was not impelled by any change in the Statutes or Regulations, since the above-quoted provision of the Revenue Act of 1928 and the appurtenant Regulation have stood substantially unchanged since the enactment of the Revenue Act of 1918.

The proper construction of the Statute and Regulation by the numerous class of concerns engaged in the same class of business has been rendered uncertain and impossible of determination because of the direct conflict of authority above referred to.

The issues here involved are therefore of widespread, practical and public importance, both to a large class of taxpayers and to the Treasury. For this reason we respectfully urge this Court to grant the writs now prayed for and undertake review of the instant proceedings.

CONCLUSION.

Wherefore, it is respectfully submitted that this petition for writs of certiorari to review the judgments of the Court of Appeals of the District of Columbia in these consolidated cases should be granted.

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